

COMMENTARY

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Sales free and clear of liens under Florida's 'assignment for benefit of creditors' law

By Isaac Marcushamer, Esq.

The ability to liquidate underwater assets has always posed particular problems for borrowers, lenders, would-be buyers and courts. Generally, one of the most effective ways to liquidate assets is to use Section 363 of the Bankruptcy Code.¹

However, as the cost of conducting a 363 sale through bankruptcy has increased, so has the desire of parties to use alternative means to achieve the same ends.

In today's economic environment an increasing number of professionals are considering using state laws governing assignments for the benefit of creditors as faster and cheaper alternatives to bankruptcy. However, this crucial strategic decision has the potential to leave borrowers, lenders and buyers without the key statutory protections that bankruptcy offers.

Consider the following all-too-familiar problem. A small company is struggling to make ends meet. In 2005 the company took out two loans from two different sources, and both loans were secured by the same piece of real property. Because of changes in the economic climate, the value of the property has dropped substantially, leaving both lenders undersecured.

Moreover, the company is no longer meeting its ongoing obligations to its trade creditors and is not able to continue to service the debt secured by the two mortgages. The company's only option is to shut its doors and liquidate the real property.

The company can choose to file for bankruptcy protection and seek to sell its assets pursuant to the Bankruptcy Code under the supervision of a bankruptcy court, or it can attempt to liquidate by initiating an assignment for the benefit of its creditors under state law, a process that is supervised by a state court.

SALES IN BANKRUPTCY COURT

Sales under the Bankruptcy Code are generally governed by 11 U.S.C. § 363(f), which provides:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

- (1) applicable non-bankruptcy law permits sale of such property free and clear of such interest;
- (2) such entity consents;
- (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- (4) such interest is in bona fide dispute; or
- (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

The court based its reasoning on the intricacies of Florida law regarding notice of filed documents and ultimately determined that the trustee would have had constructive notice of the lease interest, defeating any bona fide purchaser status. Therefore Florida law would not permit the sale of a billboard free and clear of the interest, it held.⁵

However, had the leasehold interest been imperfect under Florida law, it appears that the Bankruptcy Court would have had the authority to approve the sale under Section 363(f)(1).

Pursuant to Section 363(f)(2), the sale of property free and clear may be authorized where the entities holding the secured claims consent to such a sale. The issue under this prong generally arises with the meaning of the term "consent." Some courts

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Accordingly, if the trustee (or debtor in possession) can meet any one of the five requirements, the asset may be sold "free and clear of any interest."²

Section 363(f)(1) permits the sale of property free and clear of an interest if "applicable non-bankruptcy law permits the sale free and clear of such interest." In general this prong is used when there is an imperfect or avoidable security interest.

For example, in *South Motor Co. v. Carter-Pritchett-Hodges Inc.*, the trustee argued that the sale of a billboard free and clear of a lease interest was permissible because the lease was not recorded.³ The Bankruptcy Court held otherwise and determined that applicable Florida law would not permit the sale of the property free and clear of the leasehold interest.⁴

have held that silence does not constitute consent for the purposes of selling property free and clear under Section 363(f)(2) and that consent requires an act affirmatively approving the proposed action.

In *In re DeCelis* the Bankruptcy Court declined to approve the sale of a house free and clear of a non-debtor's interest where the non-debtor party had acquired an interest along with the debtor as tenants in common.⁶

The trustee filed a motion to sell free and clear pursuant to Section 362(f)(2), but the non-debtor tenant in common did not respond to the motion. The trustee argued that the failure to respond should be construed as consent.

The court declined to adopt the trustee's position and held that "the distinction between silence and consent is clear."

“Unless there is a duty to speak, silence signifies nothing,” the court said. “The Bankruptcy Code imposes no duty to respond to notices.”⁷

Accordingly, under *DeCelis*, unless actual consent is received, a sale under Section 363(f)(2) is impermissible.

Pursuant to Section 363(f)(3), the property may be sold free and clear “only if such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property.”⁸

The issue under this subsection is how to construe the term “value.” Many courts construe it to mean that the sale price must exceed the face value of the liens.⁹

Under this view, a sale under Section 363(f)(3) requires that the sale price exceed the value of all debts against the property.¹⁰ Of course this does not assist the sale of undersecured property because by definition a sale for more than the value of the debt proves that the lenders were oversecured.

Other courts have held that the meaning of the term “value” only encompasses the secured value, not the face amount of the liens secured by the asset.¹¹ In *In re Collins* the Bankruptcy Court reasoned that using an estimated value of the secured part of the liens provided a better solution and would permit the court to approve a sale that if delayed would result in unfair prejudice to all the creditors.¹²

Section 363(f)(4) is among the most common methods to approve a sale in bankruptcy. Under this section a bankruptcy court must examine whether there is “a factual or a legal dispute as to the validity of the claim,” according to the court in *In re Dewey Ranch Hockey*.¹³

In *In re Dewey* the court held that because the dispute did not have a factual or legal history that could be analyzed (that is, no lawsuit had been filed), this option was unavailable to the debtor. The dispute was therefore hypothetical, and this was insufficient to approve a sale over the objection of a party with an interest in the asset under Section 363(f)(4).

Lastly, a court may rely on Section 363(f)(5), which permits a sale free and clear of liens “if such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.” This provision

If a bankruptcy trustee or debtor in possession can meet any one of the five requirements of Bankruptcy Code Section 363(f), the asset may be sold “free and clear of any interest.”

is rarely invoked. However, in *In re Levitt & Sons* the bankruptcy judge noted that this requirement is a hypothetical test.¹⁴

“There is no requirement that the legal or equitable proceeding compelling the acceptance of less than full value actually occur prior to the Section 363(f)(5) sale, or if at all,” the judge said.¹⁵

Moreover, the judge noted that if the hypothetical proceeding would result in the junior creditor receiving nothing at all, such as in a foreclosure, Section 363(f)(5) would appear to authorize the same result in a bankruptcy case.¹⁶

Under the hypothetical scenario introduced at the beginning of this commentary, it is clear that only some of the provisions of Section 363(f) will help a debtor or trustee sell the property free and clear of all interests in the property, where the liens or interests exceed the value of the property.

The most effective methods are likely to be:

- A Section 363(f)(2) sale by consent.
- A Section 363(f)(3) sale where the price exceeds the value of the liens in jurisdictions that define value as the amount of the secured interest.
- A Section 363(f)(4) sale where there is a bona fide dispute with the interest holders.
- A Section 363(f)(5) sale where there is a legal or equitable proceeding in which an interest holder could be compelled to accept a money judgment in return for that interest.

It is evident from the extensive body of decisional law regarding Section 363 sales in bankruptcy cases that courts consider the rights of secured creditors while at the same time assisting in the expeditious monetization of assets.

Moreover, the concept of a sale free and clear of interests is specifically noted and defined in the Bankruptcy Code. This gives real power and legitimacy to any valid Section 363 order issued by a bankruptcy court.

As outlined in the next section, the sales provisions of assignment-for-benefit-of-creditors statutes are very different.

SALES IN ASSIGNMENTS FOR THE BENEFIT OF CREDITORS

An assignment for the benefit of creditors is state law remedy that is procedurally and substantively different from a bankruptcy. An ABC is procedurally different because it is governed by different laws. In Florida it is governed by Fla. Stat. § 727.101.

The action is filed in state court, not federal court, so the court proceedings have more limited jurisdiction; and the insolvent entity is given the right to choose to whom it assigns its assets.¹⁷

An ABC is substantively different from a bankruptcy in several ways, but for the purpose of this commentary an examination of Fla. Stat. § 727.109(7) suffices. This section provides that the court has the power to:

upon notice ... to all creditors and consensual lien holders, hear and determine a motion brought by the assignee for approval of a proposed sale of assets of the estate other than in the ordinary course of business, or the compromise or settlement of a controversy, and enter an order granting such motion notwithstanding the lack of objection if the assignee reasonably believes that such order is necessary to proceed with the action contemplated by the motion.

This is the sole provision that provides the court with the power to authorize and approve a sale of the assets of the assignor.

The statute is silent on the procedures for a sale and does not use the words “free and clear” as the Bankruptcy Code does. Therefore, some observers believe that absent the statutory authority, an ABC cannot result in a sale of assets free and clear of rights, as occurs in bankruptcy.¹⁸

However, other commentators suggest that an ABC can result in a sale free and

clear of secured interests if the secured interest holders consent to such a sale.¹⁹ The commentators' views of ABCs make it evident that none of the built-in protections that are clearly present in the Bankruptcy Code are present in an ABC.²⁰

In addition to these observers' views, the lack of reported decisions dealing with ABCs has resulted in state courts' relying on bankruptcy decisions for assistance in construing the ABC statute.

In *Moecker v. Antoine*, Florida's 1st District Court of Appeal had to determine when a claim arose for purposes of the ABC statute.²¹ Because there is no guidance in the statute, the court turned to the Bankruptcy Code and the case law construing it for guidance. It ultimately adopted the bankruptcy standard that a claim arises when the acts giving rise to the alleged liability are performed.²²

One of the side effects of state courts' using bankruptcy law to interpret the ABC statute is that bankruptcy terms of art and concepts are judicially imported into the ABC lexicon. In the sale context, the issue becomes how much of the bankruptcy parlance is to be incorporated.

For example, if a court determines that it will sell assets free and clear of liens, because such sales are permissible in bankruptcy, the court should also consider importing the limitations imposed by Section 363(f) on when a bankruptcy court may sell assets free and clear. After all, the ability to sell assets free and clear of all interests is permitted in a bankruptcy case only when one of the five enumerated requirements is met.

The case of *In re SS Funding* provides a clear example of how an ABC can be effectively derailed and delayed by a secured creditor who does not consent to the sale of assets.²³ In *SS Funding* Florida's 3rd District Court of Appeal upheld a trial court's ruling that a lien on promissory notes owned by the assignee was invalid.

The assignee had filed a motion to approve the sale of the assets free and clear of all liens, but the putative secured creditor objected. Accordingly, the assignee brought the lawsuit against the putative secured creditor in order to be able to effectuate a sale of the promissory notes free and clear of all liens.

The *SS Funding* case highlights the difference between a bankruptcy and an ABC. Had *SS*

Funding been a bankruptcy, the trustee may have been able to argue that the secured creditor's lien was the subject of a bona fide dispute or that the sale price was equivalent to the secured amount of its lien. Under the Bankruptcy Code, the status of the putative secured creditor's lien would not have required resolution before the sale could take place. This expedited sale would have allowed the bankruptcy trustee to monetize the asset quickly to prevent any further reduction in its value.

Conversely, the sale process in an ABC is necessarily less refined, and any objection may necessitate additional litigation just to allow a sale to proceed. This extra litigation and its associated delay may cause the assignee to abandon the asset because it would be economically prohibitive to successfully reach a resolution that would permit a sale, or the delay may negatively affect the value of the asset.

CONCLUSION

The need for a fast, effective and more economical alternative to bankruptcy has led to the increase in use of ABC proceedings.²⁴

The primary purpose of an ABC proceeding is to facilitate the sale of assets. However, this primary focus without regard for the statutory limits of the law under which ABCs operate can result in intensive and costly litigation that may be avoidable in a bankruptcy proceeding.

In the end, you get what you pay for when you use an assignment for the benefit of creditors, namely, a fast and in some cases efficient method to liquidate assets with court supervision.

NOTES

¹ *Integrated Solutions v. Serv. Support Specialties*, 193 B.R. 722, 728 (D.N.J.1996) (noting that Section 363 is designed to promote an expeditious and effective liquidation of the debtor's property).

² *In re Levitt & Sons*, 384 B.R. 630, 647-48 (Bankr. S.D. Fla. 2008).

³ *S. Motor Co. v. Carter-Pritchett-Hodges Inc.* (In re MMH Auto. Group LLC), 385 B.R. 347, 367 (Bankr. S.D. Fla. 2008).

⁴ *Id.*

⁵ *Id.*

⁶ *In re DeCells*, 349 B.R. 465, 466-67 (Bankr. E.D. Va. 2006).

⁷ *Id.* at 468-69.

⁸ *In re Levitt & Sons*, 384 B.R. at 648.

⁹ See *In the Matter of Riverside Inv. P'ship*, 674 F.2d 634, 640 (7th Cir. 1982); *In re Heine*, 141 B.R. 185 (Bankr. D.S.D. 1992); *In re Terrace Chalet Apartments Ltd.*, 159 B.R. 821 (N.D. Ill. 1993); *In re Mien Co.*, 117 B.R. 910 (Bankr. W.D. Tenn. 1990).

¹⁰ *In re Levitt & Sons*, 384 B.R. at 648.

¹¹ *In re Collins*, 180 B.R. 447 (Bankr. E.D. Va. 1995).

¹² *Id.*

¹³ *In re Dewey Ranch Hockey LLC*, 406 B.R. 30, 39 (Bankr. D. Ariz. 2009).

¹⁴ *In re Levitt & Sons*, 384 B.R. 465.

¹⁵ *Id.* at 648.

¹⁶ See Robert Richards, Relief Without A Petition: Non-Bankruptcy Alternatives: Practical Issues on Assignments for the Benefit of Creditors, 17 AM. BANKR. INST. L. REV. 5, 5 (Spring 2009).

¹⁷ *Id.* at 20.

¹⁸ See Jeffery Davis, Florida's Beefed-Up Assignment for the Benefit of Creditors as an Alternative to Bankruptcy, 19 U. FLA. J.L. & PUB. POL'Y 17, 37 (April 2008).

¹⁹ *Id.* ("the complex bankruptcy processes provide numerous creditor protections coupled with oversight of the U.S. trustee").

²⁰ See Richards at 5 ("Reported cases regarding ABCs are relatively few, especially modern ones.").

²¹ *Moecker v. Antoine*, 845 So. 2d 904, 911 (Fla. 1st Dist. Ct. App. 2003).

²² *Id.*

²³ *SS Funding LLC v. Phelan*, 981 So. 2d 1282 (Fla. 3rd Dist. Ct. App. 2008).

²⁴ See Harold Israel, *Busy Times Ahead In the Bankruptcy Arena*, 23 CBA RECORD 39 (January 2009) (noting that "because of the high costs of bankruptcy proceedings, we may see an increase in the use of out-of-court solutions, specifically, liquidations through assignment for the benefit of creditors").



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